 25X1

file

Central Intelligence Agency

Washington, D.C. 20505

1-file

DATE 2/10/86

DOC NO EA M 86-20007

OCR 3

P&PD 1

DIRECTORATE OF INTELLIGENCE

30 January 1986

Japan: How Fast Can it Increase Manufactures Imports?

Summary

Although Japanese imports of manufactures grew by roughly 10 percent annually over the past decade, the share of manufactures imports in GNP--2.8 percent in 1985--remains well below that of other industrial nations. We believe that Prime Minister Nakasone's special trade policy commission, which will make its report in late March, is unlikely to recommend measures that will substantially increase this ratio. We expect the committee will focus on longer-term measures, such as tax reform, that would have little impact on imports before 1990. At Nakasone's request, short-term steps such as emergency imports, another Action Plan, or an expansion of MITI's import promotion program may also be included. These measures--intended to ease trade friction before the Tokyo Economic Summit in May--would principally accelerate purchases already planned. [redacted] 25X1

Nonetheless, we believe there are policies Tokyo could implement to raise the share of manufactures imports in GNP. The CIA's econometric model of Japan suggests that a further strengthening of the yen to 180

This memorandum was prepared by [redacted] Office of East Asian Analysis. Information available as of 30 January 1986 was used in its preparation. Comments and queries are welcome and may be directed to the Chief, Japan Branch, Northeast Asia Division, OEA, [redacted]. 25X1

25X1

EA M 86-20007

[redacted] [redacted] 25X1

25X1

[redacted] 25X1

25X1

early this year, combined with a 5-percent increase in nominal government spending each year would raise manufactures imports to about 3.7 percent of GNP--about two-thirds of the US level-- by 1990. A much stronger yen appreciation--to 150 per dollar--would increase the ratio to 4.1 percent by 1990 although, in our view, it would be accompanied by the intolerable political cost of a nearly zero-growth economy. We believe the combination of a strong yen and increased government spending will raise Japan's imports of manufactures somewhat in the next few years, but our model probably overstates the impact of these policies. Principally, the model does not fully reflect shifts in the structure of Japan's imports since 1980--shifts which essentially reduce the volume of manufactures imports needed when economic activity increases. 25X1

Nakasone's Trade Policy Committee--A Blurred Vision?

Tokyo has for years strongly resisted requests to set numerical targets for increasing manufactures imports to a level matching those of other industrial nations. The US ratio averaged 5 percent in the 1980s while European countries such as West Germany and the United Kingdom have ratios in the 13-16 percent range.[1] 25X1

The standard Japanese government position, underscored to an EC delegation last fall by Nakasone and Foreign Minister Abe, is that the government cannot dictate the outcome of a free market economy. MITI, which believes it would bear the burden of enforcing import targets, remains the strongest opponent. 25X1

Japanese officials also claim to be confused by what Washington would like to see in a program to promote manufactures imports. They are unsure whether US officials want more bilateral negotiations or numerical targets; if targets, whether in value, volume, or ratio terms. More importantly, Tokyo is unclear about what US officials and Congressmen mean when they say Tokyo should adopt an "import vision" similar to MITI's well-known export and industrial visions which guided the evolution of the post-war Japanese economy.[2] 25X1

We believe the recommendations of Nakasone's special trade policy advisory group, officially the Study Group on Economic Structural Adjustments to Promote International Cooperation, will not address the "import vision" desired by the the United States or the European Community. In our judgment, the committee is likely to

---

1 If West Germany's imports of manufactures from other EC countries is excluded, however, its ratio of manufactures to GNP drops to about the US level of 5 percent. 25X1

2 MITI's latest vision, "Vision of the Industrial Structure in the 21st Century" is due out this spring and will focus on Japan's transformation to an information and services-based economy. 25X1

25X1

[redacted] 25X1

recommend measures such as major tax reform and deregulation of the private sector, which--even if implemented quickly--will take several years to affect imports. [redacted] 25X1

Nakasone wants the countries attending the summit in May to give the report favorable reviews. As a consequence, the the committee also may recommend some measures to increase imports immediately--such as an emergency import initiative, a modest increase in public works, an expansion of MITI's import promotion campaign, and possibly an Action Plan II to further reduce tariff and non-tariff u barriers to imports. Unless these measures go well beyond similar programs in the past, however, they will do little more than accelerate purchases already planned. [redacted] 25X1

Economic Policy Options

Tokyo, in our view, could adopt policies which would raise the ratio of manufactures imports to GNP from the current 2.8 percent to about 3.5 percent of GNP by 1990. (See attached Table) These policies consist of maintaining a strong yen and implementing a modest increase in government spending. Numerous studies indicate that manufactures imports are responsive to changes in relative prices and to changes in economic activity.[3] [redacted] 25X1

We used the CIA's econometric model of Japan to examine the impact on manufactures imports of alternative exchange rate and fiscal stimulus packages. (see table) We also computed how much manufactures imports would have to grow to reach the US ratio of 5 percent of GNP by 1990--a 15 percent annual increase. The scenario that is most likely--an exchange rate of 180 per dollar and no increase in government spending--results in the ratio of manufactures imports to GNP rising from 2.8 percent to 3.5 percent by 1988. (The major impact of all the scenarios on this ratio occurred within three years.) Even the most extreme case we considered with the model, a yen/dollar exchange rate of 150, produces only a modest additional increase in the ratio. [redacted] 25X1

We believe our model results correctly suggest that a combination of a strong yen and fiscal stimulus will raise manufactures imports, but the model probably overstates their impact considerably. Changes in the composition of manufactures imports and in the responsiveness of these imports to relative price and income changes have occurred since 1980.[4] The model--constructed in 1982--does not fully reflect these changes in industrial structure.

---

[3] The Bank of Japan estimates that the price elasticity of demand for manufactures imports was 1.08 in recent years, while that for intermediate goods was 1.25. The Bank studies also suggest that intermediate goods are becoming less price sensitive and capital and consumer goods more price sensitive and thus more likely to increase when the yen strengthens.[redacted] 25X1

[4] These changes are documented in a recent Bank of Japan study. [redacted] 25X1

[redacted] 25X1

- Japanese firms responded to sharp increases in resource prices by becoming more efficient in using both raw materials and intermediate goods. As a result, Japanese industry uses fewer inputs per unit of output now than before 1979.

- Imported intermediate goods became relatively cheaper after 1979, but we believe the increased imports resulting from this change has probably run its course.

- The sharp growth in capital goods imports reflects in part the investment boom and cost-cutting innovations of the early 1980s. Such investment is expected to grow more slowly in next few years and Japanese machinery has gained a cost advantage it did not have in 1979.

- Imports of consumer goods--which so far have not been very amenable to administrative guidance--have not risen substantially in response to either lower prices or higher incomes.

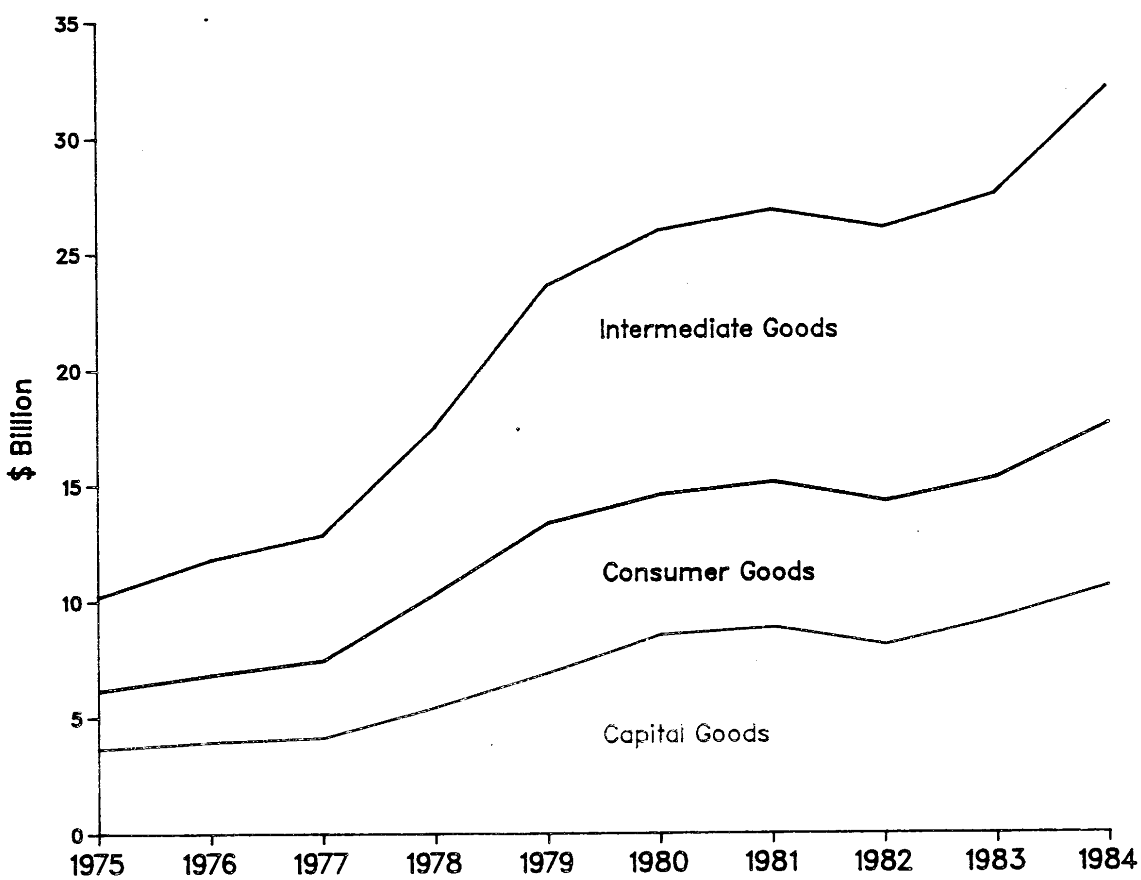
As a result of these changes and a slowing of the Japanese economy, the average annual growth of manufactures imports fell to roughly 5 percent since 1980. For Japanese manufactures imports to equal even 4 percent of GNP by 1990, the growth rate would have to double--and return to the rate of the booming 1970s. 25X1

Economic Costs and Political Constraints

As long as Tokyo continues its commitment to budget austerity, it will be difficult for the government to stimulate imports of manufactures much beyond the level the economy would naturally generate with a yen/dollar exchange rate of 180. We believe Japanese policymakers, however, would be willing to accompany a yen of 180 with modest fiscal stimulus--say 5 to 10 percent increase in government spending--rather than try to strengthen the yen much beyond 180. The Economic Planning Agency's econometric model--on which our model is based--almost certainly shows a sharp contraction in the growth rate --to below 2 percent-- if the yen appreciates much beyond 180. Three percent has traditionally been considered the minimum politically acceptable growth rate. 25X1

Tokyo is likely to accompany any efforts to boost manufactures imports with an expanded program of administrative guidance--"jawboning"--to boost manufactures imports. Recent reports from the US Embassy in Tokyo indicate that MITI's current program, in which 134 companies have promised to expand their imports of manufactures, will boost total imports only slightly in 1986. Some Japanese companies are including purchases from US-owned companies in Japan in their reports to MITI. An expanded program of administrative guidance, moreover, will require an increase in MITI's powers to influence corporate decisions. If this occurs, MITI's writ more easily could be used to encourage exports or direct research into directions the Ministry desires. 25X1

Japan: Composition of Manufactures Imports



JAPAN: MANUFACTURES IMPORTS UNDER ALTERNATIVE EXCHANGE RATE AND FISCAL STIMULUS SCENARIOS
(Trillion yen)

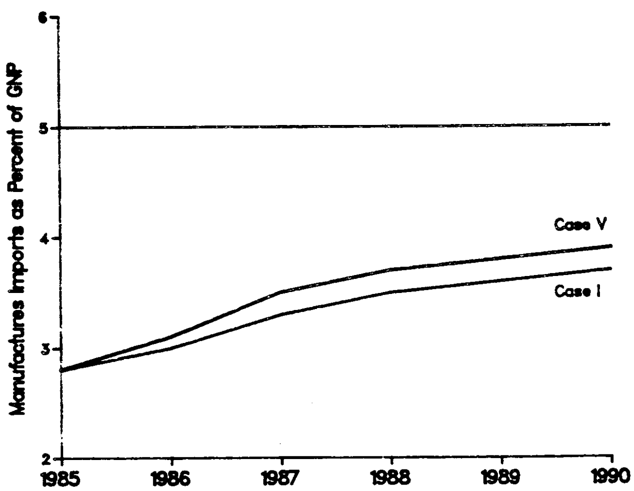
Year	Value of imports needed to raise share of manufactures imports in GNP to 5 percent[1]	Value of Imports Attained Under[2]: Case I: Yen/dollar of 180 by 86:2; no increase in fiscal stimulus	Case II: Yen/dollar of 150 by 86:4; no increase in fiscal stimulus	Case III: Yen/dollar of 180 by 86:2; 5% rise in government spending	Case IV: Yen/dollar of 170 by 86:4; 7% rise in government spending	Case V: Yen/dollar of 180 by 86:2; 10% rise in government spending
1985	8.8	8.8 (2.8% GNP)	8.8 (2.8% GNP)	8.8 (2.8% GNP)	8.8 (2.8% GNP)	8.8 (2.8% GNP)
1986	16.4	9.1 (3.0% GNP)	10.0 (3.1% GNP)	10.0 (3.1% GNP)	11.0 (3.2% GNP)	10.1 (3.1% GNP)
1987	17.3	11.2 (3.3% GNP)	12.1 (3.5% GNP)	11.6 (3.3% GNP)	12.2 (3.4% GNP)	12.3 (3.5% GNP)
1988	18.1	13.4 (3.5% GNP)	14.1 (3.7% GNP)	13.6 (3.6% GNP)	13.9 (3.6% GNP)	14.0 (3.7% GNP)
1989	19.0	14.7 (3.6% GNP)	15.6 (4.0% GNP)	15.0 (3.7% GNP)	15.3 (3.8% GNP)	15.4 (3.8% GNP)
1990	20.0	16.2 (3.7% GNP)	17.1 (4.1% GNP)	16.5 (3.8% GNP)	16.8 (3.8% GNP)	16.9 (3.9% GNP)
Compound Growth Rate of Imports (1985-1990)	14.7%	10.7%	12.3%	11.0%	11.3%	11.5%

[1] Assumes nominal annual GNP growth of 5 percent. Imports would have to grow at 36 percent annually to reach the West German share of 13 percent and at 30 percent annually to reach a 10 percent share of GNP by 1990.

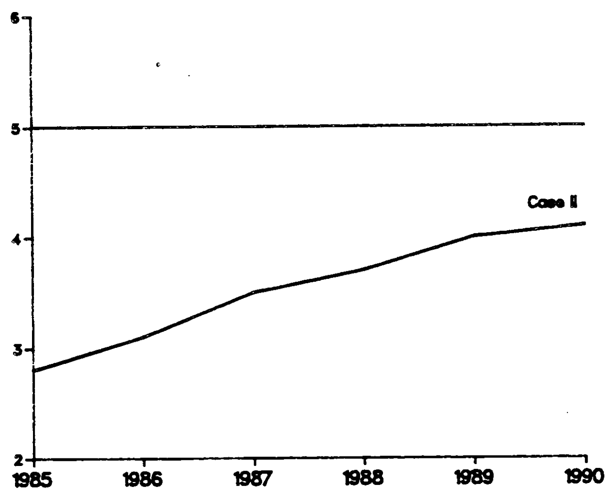
[2] CIA model calculates imports only through 1988, so we extended estimates by increasing the value of imports 10 percent in 1989 and 1990. Previous simulations suggest most of the impact of a stronger yen and increased fiscal stimulus is felt within 3 years. (Note that nominal GNP varies in cases I-V and is determined within the model)

25X1

Japanese Imports of Manufactures: The Role of Exchange Rates, Fiscal Stimulus, and Administrative Guidance



Case I,V
(yen/dollar rate of 180 by 86:2,
no increase in government spending for I;
add a 10% fiscal stimulus for Case V.)



Case II
(yen/dollar rate of 150 by 86:4
no increase in government spending.)

An appreciation of the yen to 150 per dollar by the end of 1986 increases the ratio of manufactures imports to GNP little beyond what we expect to occur naturally (Case I), or with a substantial fiscal stimulus (Case V).

SUBJECT: Japan: How Fast Can it Increase Manufactures Imports?

Distribution:

Original - Joseph Massey, Assistant Trade Rep. for Japan/USTR
1 - OEA/NEA/Japan Branch
1 - NIO/EA (7E-62)
1 - NIO/Economics
1 - C/PPS/DO (3D 01)
1 - C/EA/[redacted] (5E 18) 25X1
1 - OGI/IIC/PI
1 - OEA/NEA/Korea Branch
1 - OEA/NEA/STI Branch
1 - OEA/NEA Division
1 - OEA/China Division
1 - OEA/SEA Division
1 - D/OEA (4F 18)
1 - C/Research/OEA
1 - FBIS Analysis Group
1 - DDI
1 - Senior Review Panel
1 - PDB Staff (7F 30)
5 - CPAS/IMC/CG (7G 07)
1 - CPAS/ILS (7F 50) 25X1
1 - C/PES (7F 24)
1 - NIC/AG (7E 47)
1 - DDO/EA Division
1 - DDO/EA/[redacted] (5E 22)
[redacted] 25X1
1 - OCR/EAD/AB (1H 18)

DDI/OEA/NEA/Japan/[redacted] 30 January 1986 25X1